EAST KENTUCKY POWER COOPERATIVE

Case No. 2000-00079

RECEIVED
OCT 6 2004
PUBLIC SERVICE COMMISSION

October 5, 2004

CERTIFIED MAIL
RETURN RECEIPT REQUESTED

Mr. Harry Graves
President
Kentucky Pioneer Energy, L.L.C.
312 Walnut Street
Suite 2000
Cincinnati, Ohio 45202

RECEIVED
KENTUCKY STATE BOARD ON
OCT 06 2004
ELECTRIC GENERATION AND
TRANSMISSION SITING

Re: Power Purchase Agreement Dated January 14, 1999
Notice of Default and Termination

Dear Mr. Graves:

Pursuant to Sections 9.3 and 9.4 of the Power Purchase Agreement between East Kentucky Power Cooperative, Inc., ("EKPC") and Kentucky Pioneer Energy, L.L.C. ("KPE") dated January 14, 1999, as amended, (the "Agreement"), EKPC hereby notifies KPE that it is exercising its option to terminate the Agreement. The basis for this termination is the failure of KPE to obtain financing for the KPE Project by the extended milestone date of June 30, 2001, and its failure to achieve commercial operation of the Project by the milestone date of March 31, 2004.

The original terms of the PPA offered substantial benefits to EKPC, and made the KPE Project very attractive. However, since KPE's failure to meet the extended Financial Closure date of June 30, 2001, various changes proposed in the Agreement terms by KPE have substantially reduced the anticipated benefits of the Project to EKPC, while the risks of the Project have remained. Further, KPE has failed to provide EKPC with adequate information to demonstrate that any restructuring of the Project is technically and financially feasible. Many of the same concerns we have are also shared by the Kentucky Public Service Commission. As you know, the Commission initiated its own investigation into the validity of the Agreement and the prudency of EKPC relying upon KPE for future power supply, in view of problems with missed dates, lack of financing and commercial feasibility of the project.

Sufficient progress in restructuring the Project has not been made to make it prudent for EKPC to consider the Project for its next identified power supply needs, for which EKPC must now take decisive actions. EKPC can no longer wait for the uncertainties surrounding the Project to be resolved, and cannot take major risks on a Project that no longer offers the substantial benefits of the original Agreement terms.

By this letter, EKPC is also declaring KPE to be in default of the Agreement, pursuant to Section 14.1 (b), and issuing a notice of termination pursuant to Section 9.5, based on KPE's failure to obtain Project financing by June 30, 2001, and its failure to commence

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commercial operation by March 31, 2004. It is EKPC's judgment that KPE has continuously failed to pursue appropriate efforts to develop and complete the Project consistent with the terms of the Agreement, and with the understandings reflected in the original approval of the Agreement by the Public Service Commission. Such approval, as stated in the Commission's order dated July 11, 2000, in Case No. 2000-079, related to a plant constructed, owned and operated by KPE, which would supply power at the contract price, using a mixture of coal and refuse derived fuel, by the commercial operation date of March 31, 2004. KPE has never demonstrated to EKPC that the original project was ever feasible, and completion of such a project under the schedule in the Agreement is now, clearly, impossible.

While the Board of Directors has authorized this notice of default, EKPC does not desire to implement litigation against KPE, but would prefer to settle all issues relating to the Agreement. EKPC believes that the Agreement must be terminated, and proposes that the Parties agree to move on and bear their respective expenses to date, as originally contemplated in the event of an optional termination of the Agreement. It will not be necessary to terminate the Site Lease for the Project, since it expired by its own terms on September 30, 2000, pursuant to Section 15.11 (b).

EKPC recognizes that the Agreement allows KPE time to attempt to cure the deficiencies which are the basis for this notice of default and termination. If KPE desires to utilize its rights to attempt to comply with these conditions, please provide me with notice of that fact, and EKPC will not object to such a course of action. However, if KPE is not able to cure those deficiencies, and acceptable terms for settlement cannot be reached in a reasonable time, EKPC will pursue the legal and equitable remedies available to it.

EKPC believes that both parties will benefit from a quick resolution of this situation. It is EKPC's intention to draft a brief document which would memorialize the termination of the Agreement and the settlement of all matters relating to it. If you agree with this plan, please let me know and I will have a copy of the document sent to you.

Sincerely,

Roy M. Palk

Roy M. Palk
President and Chief Executive Officer

Cc: Kentucky Public Service Commission
Mike Musulin
Kenneth C. H. Willig, Piper & Marbury, L.L.P.
Administrator- Rural Utilities Service

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